

GOVERNMENTS AND THE THEORY OF THE FIRM

Henry Hansmann
Yale Law School

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My Focus Is on the Role and Structure of Governments

- Not on the nation-state
 - There's a rapidly growing economics literature there
- Rather, on local governments
- They're important
 - There are 90,000 in the United States
 - Their share of GNP is growing faster than the national government's share
- But the role and structure of governments has been much neglected by scholarship in law, economics, and political science
- I'll just focus on some broad issues

Governments Are Generally Viewed as Distinct from Private Firms

- In contrast, I'll try to offer a common framework
 - Rooted in institutional economics
 - Focused on U.S. institutions
 - But analysis is general
 - Comparison with other countries raises important questions
- I won't make many references to the literature

We Must Begin with a Definition of “Government”

- There is evidently no standard definition
 - We have to provide one
- A (classical, or territorial) government is:
 - A legal entity
 - Associated with a defined territory
 - With the authority to provide services to residents of the territory
 - And the authority to require payment for the services from the residents

Some Elaboration

- Payment may be extracted through:
 - General taxes (on, e.g., property, sales, or income)
 - Assessments calculated according to estimated benefits received
 - User fees
- A resident must leave the territory to escape liability for assessments
- Nearly all governments are regulated by higher-level governments, as with private organizations

Control

- Governments can be:
 - Autocratic (directors are self-perpetuating)
 - Hierarchical (directors are appointed by a higher-level government)
 - Democratic (directors are elected by residents)
- I'll focus primarily on:
 - Democratic governments
 - In the United States

“Government,” not “The State”

- Weber: state holds “the monopoly of the legitimate use of physical force within a given territory.”
- But most governments have no guns (and nearly none did before 1840)
- Rather, most governments compel payment of assessments the same way a merchant compels payment of purchase prices:
 - By bringing a lawsuit

Governments Differ from Private Enterprise Principally in Formation

- Can be formed by higher government and/or vote of local residents
- Either way, all residents of designated territory become members of the government
 - Must pay assessments
- Condominium apartment building or rural electricity cooperative can't do that
 - Though the latter can come very close
- After formation, governments and private firms are very similar
 - Majority vote of members controls

Governments Provide Territorially Monopolistic Services

- Such as roads, sewage systems, mosquito abatement, traffic regulation, zoning, courts to decide disputes involving externalities
- Don't operate in Tiebout's world: residents face relatively high costs of moving
 - E.g., because of territory-specific investments in employment, housing, friends, schools, etc.

Don't Generally Produce:

- Public goods, such as radio or TV broadcasting
 - Generally privately provided
- Goods whose quantity or quality is difficult for customers to assess
 - E.g. medical care, nursing care, or child care
 - These are generally provided by nonprofits where proprietary firms are inadequate

Governments Are Essentially Territorial Cooperatives

- Democratic governments provide customer ownership of monopoly services
- Just like private cooperatives
- There's much overlap between services provided by coops and those provided (or regulated) by local governments:
 - E.g., electricity, telephone, water
- Other private organizations are even closer to governments:
 - Residential condominiums
 - Homeowners' associations
 - Planned communities

Costs of Voting

- Private coops reflect a strong tradeoff between:
 - Costs of monopoly
 - Costs of collective decision-making when interests of voters are heterogeneous
- Evidence suggests latter are often high
 - Costly procedures (getting information, organizing)
 - Bad decisions (uninformed, exploitative)
- Coops – indeed all firms with multiple owners – generally survive only where customer-owners are, or can be made to be, highly homogeneous in their interests in the firm
 - E.g., corn farmers, hardware retailers, taxi drivers, lawyers
 - And shareholders in business corporations

The Same Should Be True of Governments

- Survivorship should (roughly) select for efficiency in governmental structures
- Governments should adopt strategies to homogenize interests of resident-voters
 - E.g., boundaries of territory
- So we can look at organizational trends for evidence of comparative costs and benefits of alternative structures

Consider Number of Purposes

- The 2012 U.S. Census of Governments counts roughly 90,000 “governmental units”
 - 40,000 general-purpose governments (“GPGs”)
 - Counties
 - Municipalities
 - Townships
 - 50,000 special-purpose governments (“SPGs”)
 - 13,000 school districts
 - We’ll ignore these until later
 - 37,000 “special” districts
 - We’ll focus particularly on these

Special Purpose Governments

- Also called “special districts” or “special assessment districts”
- Pursue a single purpose – providing one or another of the same services provided by GPGs
 - E.g. sewage, electricity, sidewalks, street lighting, parks, irrigation, mosquito abatement, road maintenance, fire protection, hospitals
- Have attributes similar to GPGs, but provide a single service
- Formed by private initiative with majority vote of residents of proposed territory
- Governed by state enabling statutes
- Increasing rapidly in economic importance

Fundamental Question

- Why just single-purpose or general-purpose governments?
 - Why no two-purpose or three-purpose governments?
 - Law isn't the constraining factor
- Proposed answer: These are the two best strategies for limiting costs of collective decision-making

Single-Purpose Solution to Homogeneity of Electorate

- E.g., irrigation district for a watershed
 - Members are landowners
 - Assessments and votes are based on benefits – e.g. acres in agricultural production
- Induces single-peaked preferences
 - Principal concern is aggregate water flow
- Adding a second purpose – e.g., electricity distribution or fire protection – would allow customers of one service to exert monopoly power over the other
- Adding a third service could result in no stable coalition at all

Many-Purpose Solution to Homogeneity of Electorate

- A government for every service involves much redundancy
- The most workable alternative to multiple SPGs is apparently at the other extreme:
 - Bundle together in one organization as many services as possible
- As the number of services increases:
 - Ability and incentive to form a stable exploitative coalition of residents decreases
 - Homogeneity of interest in package as a whole increases
- Presses residents toward a common interest in efficient management of all services in a general bundle
- Explains why a given territory rarely has more than one GPG, though it may have many SPGs.

City Manager Model Goes Further

- City council members elected at large
 - Strongly homogenizes voting outcomes
- Council hires professional manager
- Model is a product of the Progressive Era
 - Has been slowly but steadily spreading since
- There's reason for skepticism about recent proposals to increase partisanship in local elections

Constitutional Voting Rights

- U.S. Supreme Court has extended a one-person-one-vote rule to all GPGs.
- But not to SPGs, except for school districts.
- Court says the criterion is whether the entity provides "governmental" services.
 - Silly: SPGs and GPGs provide the same services.
- Rather, it's easy -- and necessary -- to treat SPGs differently from GPGs because they're polar solutions to the voting problem:
 - So there's no ambiguity in regulating their voting rights differently.
 - Voting proportional to interest is key in SPGs, not GPGs

Hybrid Structures

- Increasingly, municipalities are spinning off individual services to SPGs serving the same territory
 - Presumably homogenizes voting while maintaining some economies of scope
 - Presumably most useful when service is a major part of budget
 - Like primary and secondary education
 - Would unbalance homogeneity of interest in general SPG service package

More on School Districts

- Very heterogeneous demand
 - Voting by residents may provide too little (or too much)
 - Funding with general taxes tends to subsidize families with children
- So formation of districts is compelled by state
 - Also one-person-one-vote
 - And taxation is regulated and subsidized by state

Free Formation of Governments?

- Initially, states adopted a separate enabling statute for each different type of SPG
 - And required approval by state official
- Current tendency is toward:
 - A single general enabling statute
 - No ex ante approval
- Same evolutionary pattern as:
 - Business (joint stock) corporations
 - Cooperative corporations
 - Nonprofit corporations
- A general solution to the problem of collective action (Olson, Ostrom)?

Toward Governmental Fragmentation?

- Economies of scale in territorial defense now far exceed those for most other governmental services
- And other services can be provided by specialized governments that have different territories
- Perhaps this is what a post-Westphalian world, without nation-states, will look like

Why So Few SPGs in Other Countries?

- Largely a U.S. phenomenon
- Switzerland uses them
- And Bruno Frey, almost uniquely, has studied them

Non-Territorial Governments

- Have long existed for trades pursued by individuals:
 - Guilds
 - Bar associations
 - Trade unions
- Self-regulatory and standard-setting organizations (SROs and SSOs) are now extremely important
 - Have firms as members
 - Generally voluntary
 - But have de facto monopoly
 - And sometimes have governmental authority
- Should SROs be permitted to form as governments?
 - As of right?
 - Can antitrust problems be dealt with separately, as with business corporations?

Conclusion

- Governments are closer to private enterprise than conventional discourse suggests
- Simple analytic tools taken from the analysis of private enterprise can help illuminate the role and structure of “public” enterprise as well